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BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission  
**DOCKETED**

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**COMMISSIONERS**

JEFF HATCH-MILLER -- Chairman  
WILLIAM A. MUNDELL  
MARC SPITZER  
MIKE GLEASON  
KRISTIN K. MAYES

MAY 27 2005

DOCKETED BY

RS

IN THE MATTER OF THE APPLICATION OF  
CHAPARRAL CITY WATER COMPANY, INC.,  
AN ARIZONA CORPORATION, FOR A  
DETERMINATION OF THE CURRENT FAIR  
VALUE OF ITS UTILITY PLANT AND  
PROPERTY AND FOR INCREASES IN ITS  
RATES AND CHARGES FOR UTILITY SERVICE  
BASED THEREON.

DOCKET NO. W-02113A-04-0616

**STAFF'S NOTICE OF FILING  
WITNESS SUMMARIES**

Staff of the Arizona Corporation Commission hereby files the Witness Summary of Alejandro  
Ramirez, of the Utilities Division in the above-referenced matter.

RESPECTFULLY SUBMITTED this 27<sup>th</sup> day of May, 2005.

*David Ronald*

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The original and thirteen (13) copies  
of the foregoing were filed this  
27<sup>th</sup> day of May, 2005 with:

Docket Control  
Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, Arizona 85007

Copy of the foregoing were mailed  
this 27<sup>th</sup> day of May, 2005 to:


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19 David M. Ronald  
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**SUMMARY OF THE DIRECT AND SURREBUTTAL TESTIMONIES  
OF  
STAFF WITNESS  
ALEJANDRO RAMIREZ  
IN THE RATE CASE FILED BY  
CHAPARRAL CITY WATER COMPANY, INC.  
DOCKET NO. DOCKET NO. W-02113A-04-0616**

**Staff's Comments on the Testimony of Company Witness Thomas Bourassa.**

Mr. Bourassa's recommendation to determine the Company's earnings requirement by multiplying the ROR by the Fair Value Rate Base ("FVRB") rather than multiplying the ROR by the Original Cost Rate Base ("OCRB") and solving for a ROR that, when applied to the FVRB, produces the same dollar level of earnings, should be rejected for the following reasons:

1. If Mr. Bourassa's recommendation was adopted the Company and its investors would receive a windfall gain at the expense of Arizona consumers.
2. If Mr. Bourassa's recommendation was adopted, and Chaparral City Water FVRB was smaller than its original cost rate base ("OCRB"), the Company would expect to earn *less* than the cost of capital on its investment.
3. If Chaparral City Water FVRB was smaller than its OCRB and the market-based ROR was multiplied by the FVRB to determine earnings, the Company would not expect to be able to maintain its credit.

**Staff's Recommended Rate of Return**

Staff recommends the following rate of return:

	Weight	Cost	Weighted Cost
Debt	41.2%	5.1%	2.1%
Equity	58.8%	9.3%	5.5%
Cost of Capital/ROR			<b>7.6%</b>

Staff's recommended rate of return ("ROR") is based on its updated return on equity ("ROE") recommendation, its updated cost of debt recommendation, and updated capital structure.

Staff's ROE recommendation is based on the results of its updated discounted cash flow ("DCF") and capital asset pricing model ("CAPM") cost of equity estimates, shown below:

Model	Estimate
Discounted Cash Flow	9.3%
Capital Asset Pricing Model	9.2%
Average	9.3%

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**Staff's Comments on the Testimony of Company Witness Thomas M. Zepp.**

The Commission should reject Dr. Zepp's ROE estimates for the following reasons:

1. Dr. Zepp's exclusive reliance on analysts' forecasts in his restatement of Staff's discounted cash flow ("DCF") analysis is inappropriate because it assumes that investors ignore other information such as past growth.
2. The Commission should *not* rely on Dr. Zepp's restatement of Staff's constant growth DCF estimate because Dr. Zepp relies solely on analysts' forecast which causes inflated growth, thus, inflated cost of equity estimates.
3. The Commission should *not* rely on Dr. Zepp's restatement of Staff's multi-stage DCF estimate because Dr. Zepp misapplies Staff's br growth projections, and his assumptions are speculative.
4. The Commission should *not* rely on interest rate "projections" made by professional analysts because "the direction of interest rates cannot be predicted any better than by a flip of a coin." Analysts who project interest rates do not have any more information than what is already reflected in the current rate.
5. The Commission should *not* rely on Dr. Zepp's restatement of Staff's CAPM estimate because Dr. Zepp incorrectly uses the forecast of long-term treasury bond as his risk-free rate which results on upwardly biased estimates.
6. The "risk premium" analysis presented by Dr. Zepp should be rejected because (1) it relies on analysts' forecasts of future interest rates, (2) it relies on past accounting returns on equity and past authorized returns on equity which cannot be meaningfully compared to the cost of equity.
7. Dr. Zepp's proposal for additional basis points due to unique risk should be rejected because it is (1) inconsistent with financial theory, and (2) Dr. Zepp has not demonstrated that these risks affect the cost of equity for Chaparral City.